DOW THEORY LETTERS INC.

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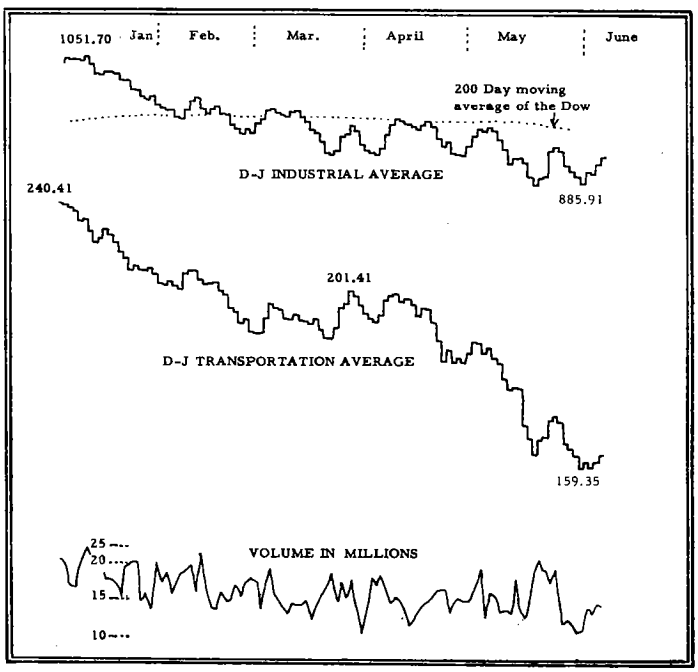
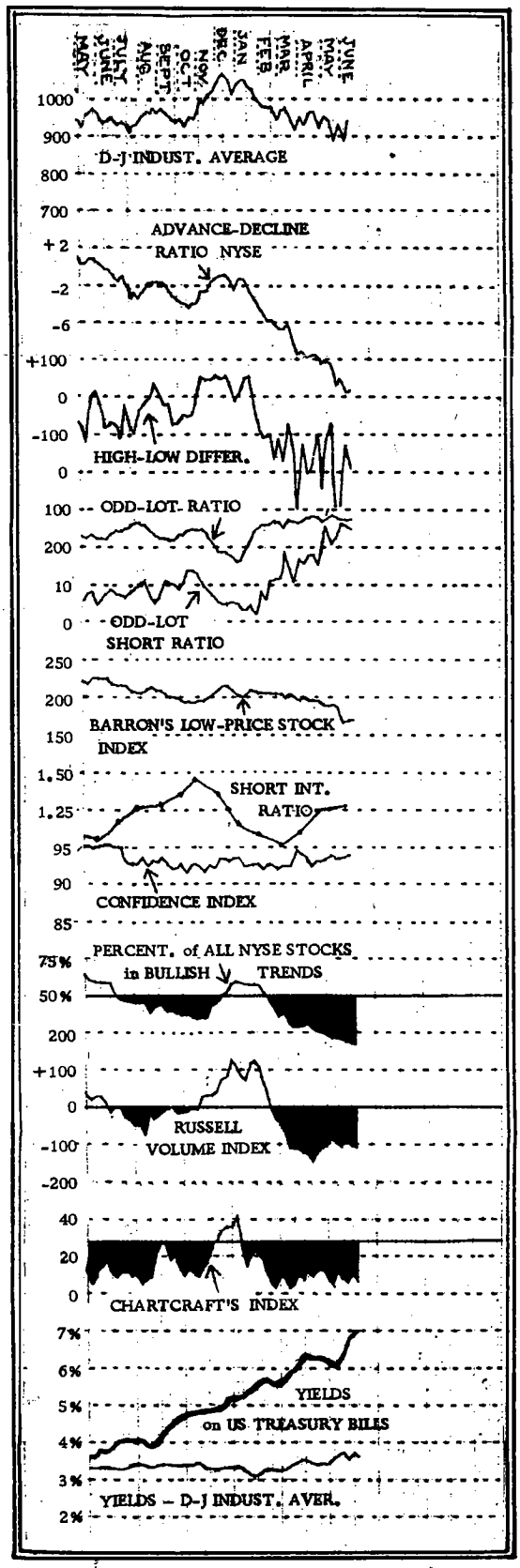
THE MARKET: Every primary bear market is different, and the reasons for every bear market are different. I have been asked why, in my opinion, Wall Street is in the process of being pulverized. My answer is that we are currently seeing the greatest destruction of capital in world history. For instance, the total public and private debt of the US is $5½ trillion. The two recent US devaluation amounted to 18% or a loss of over $1 trillion in savings!

The fact is that large dollar holders are either stupefied or panicked at their present predicament. Watergate is being blamed as the reason for the dollar's slump, but the slump has been going on for a long time. The recent explosion in the dollar price of gold is simply dramatizing the panic, and politicians feel more "comfortable" when they can blame a news event (such as Watergate) rather than a deliberate government policy (inflation) for the demise of the US greenback.

What's a dollar worth today? When monetary chaos reigns, there is only one island of real value. It's the same island that has been there for the past 5,000 years — gold. So one gauge remains: We know it took 35 dollars to purchase an ounce of gold two years ago. It takes almost four times that many dollars to buy the same ounce of gold on the free market today. And if that isn't monetary destruction, I don't know what is.

What about common stocks? Here the story is just as incredible. The broad (unweighted) NYSE Average is down about 33% from its March, 1972, peak, and a comparable Amex index is down a whopping 50%. The real results in terms of the relationship between gold and common stocks are rather shocking. For instance, an ounce of gold today will purchase more than eight times as much in terms of the Amex Index as it did two years ago. An ounce of gold today will buy about six times as much of the NYSE index as it did two years ago.





Is that the real story that the stock market is telling us now? Is the market telling us that corporations are enjoying a "fake prosperity" in that they are showing profits in a fantasy currency which is rapidly following the old German mark into extinction? Is America's prosperity going to wind up like this little scene which has just popped into my mind? The wild-eyed businessman is bending over his mahogany desk, a giant pile of money cupped in his arms, a stock ticker chattering incessantly, papers, reports, plans scattered about the room. A few feet away we hear two men conversing in hushed tones: "It's really too bad," murmurs one of the men, "Old Sam does seem to have talent. I haven't got the heart to tell him he's playing with Monopoly money. Who knows, he might have done just as well if it were all for real."

Although the advance-decline ratio, the Transportation Average and most individual stocks have since January, 1973, been going through what appears to be a semi-crash, the widely-watched D-J Industrial Average seems to have been subject to no more than a series of costly "convulsions." Since the 1051.71 all-time high of January 11, 1973, Industrials have traced out a remarkable series of 13 rallies and declines (see page 1 chart). Those of us who have learned to live without rose-colored glasses note that the advances and declines have traced out a series of lower peaks and valleys, and as long as this process persists there remains the possibility that one of the valleys could turn into a giant deep-bottomed chasm.

I have been saying that this market appears to have "split," turned schizophrenic like a man singing a church hymn while at the same time he is strangling his neighbor in the next pew. What is happening, of course, is that the "following" for 90% of the market has disappeared, and the following was the public. On the other hand, many of the Dow-type stocks and perhaps 100 other leading issues have the (at least current) "protection" of the institutions and funds.

In a remarkable article in the June 2 issue of Business Week ("Are the Institutions Wrecking Wall Street?"), some salient points are discussed. For instance, according to C.V. Woods (Chairman of the newly-formed Committee of Publicly Owned Companies), "...there are 200 or 300 stocks today in which liquidity is impressive."..."But a Boston executive puts the figure at only '25 to 35'."..."Less important than what the institutions hold, though, is what they are buying today. Notes Whitehead, 'One of our largest banks received over $1 billion in retirement and pension fund money to invest last year. It placed 65% of that in just 7 stocks, another 20% in 8 others, and the balance in just 15 more'." ..."Perhaps the most disturbing aspect of this is that innumerable pension funds, which look rich on paper, would look considerably poorer if the stocks they are invested in ever had to be sold: many would even be actuarily unsound."

In the last Letter I discussed the thesis of a coming upward correction. Although I am bearish on the long-term or primary trend of the market, it is well to understand that regarding the secondary or intermediate term, one should "ease up" on his bearishness in direct proportion to the length of a downward trend. This is a process which is direct opposition to our emotions ("The market looks awful, it's going to zero!) and in conflict from what we will hear on all sides (the public and the "experts" usually increase their pessimism in direct relationship to their losses).

The fact is that from the January 11 (1973) peak of 1051.70 to the June 4 low of 885.91, the Dow lost 166 points, and the damage outside the Dow was frightful. All history suggests that in due time (we could be in it now) we are going to get a corrective rally which will recoup approximately 1/3rd to 2/3rd of the ground lost. It will very likely be a violent rally and a good deal broader than any of the pitiful advances seen so far in 1973.

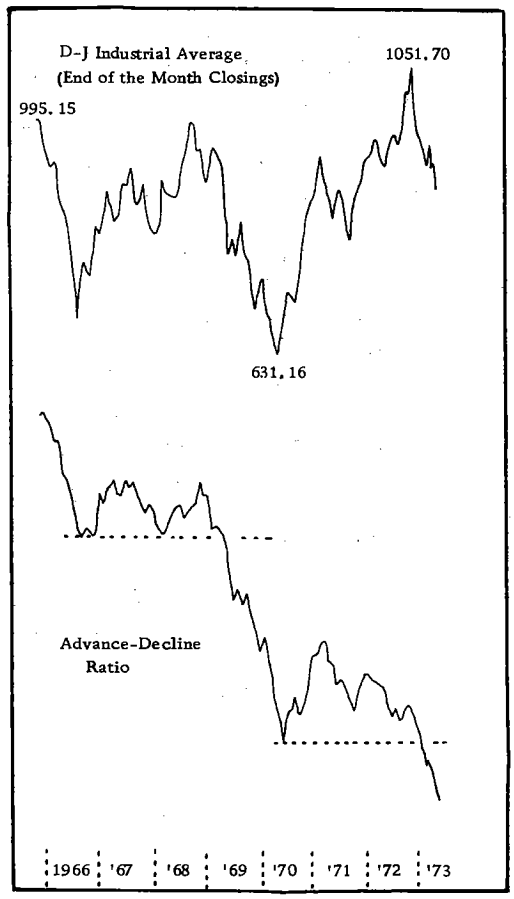
When the rally really gets underway, you can bet on the following (1) All Wall Street will agree that "the tide has turned." (2) Various Government spokesmen will announce that "all is well in the nation" because the stock market is going up. (3) Every effort will be made to lure the public back into equities. I am saying here and now that the tide will not have turned, all will not be well in the US, and the public will not be returning any time soon. What we will be witnessing is a rally in a bear market, and such rallies, by the way, have a habit of looking more "real" than the often plodding advances so characteristic of upmoves in true primary bull markets.

NEW APPROACH: There are a number of original studies which I am anxious to introduce to subscribers in coming weeks including a new "Most-Active Stock Index," a new method for interpreting "On-Balance-Volume" in the Dow, plus an absorbing interpretation of the entire market situation as seen by my correspondent, Mr. A.J. Frost of Canada, in my opinion the leading living exponent of the Elliot Wave Principle.

In this Letter, I want to discuss a fascinating thesis set forth by the veteran Wall Street analyst, George Lindsay in his mid-May report (Lindsay's Opinion, PO Box 655, Midtown Sta., NYC 10018). Lindsay comments on the long-range picture in the A-D ratio (see page 3 chart) and he describes it as follows.

First Lindsay examines some history, and for that he turns to the 1942-46 era. The A-D ratio turned up from the depressed, World War II lows of early-1942, and it continued advancing until 1946. That four-year rise represented the greatest bull market in breadth (i.e., the A-D ratio) in stock market history (older subscribers refer to the historical chart in Letter 541, newer

subscribers may send a stamped, self-addressed envelope for a xerox copy of this chart). Lindsay notes that the Dow Industrials tended to "crawl" up during 1944 to mid-1946, even though the A-D ratio advanced strongly throughout that period. What the A-D ratio was saying, opines Lindsay, was that a major market boom lay ahead. The extraordinary bull market in breadth was offering a "prediction" of much higher prices in the future (remember, the great 1942-46 advance in the A-D ratio came following 13 years of depression and war, and stocks had become great values during the 1940's).



Actually, it took another seven years (until 1954) before the Dow finally bettered its 1929 high of 381, and the big boom of the 1950's and '60's was on. But what of the situation today? "What we are seeing today," observes Lindsay, "is the obverse of the situation in 1944. The A-D line has been consistently weaker than the market for a long time." I have included my eight-year chart of the A-D ratio, showing that we are indeed witnessing the reverse of the situation of the 1940's. The Dow has been moving sideways to mildly down since 1966 while the A-D ratio has been in a state of utter collapse.

How could this be? Lindsay explains that many of the hundreds of newly-listed stocks had been bid up to totally unrealistic prices, although many of these unseasoned equities actually deserve to sell at perhaps 2 or 3 times earnings (as would be the case if these newly-listed equities had been sold as private companies without benefit of public enthusiasm).

As far as the Dow stocks are concerned, Lindsay points out that these 30 issues are, for the most part, the "old blue chips" of the 1940's and '50's. They are, as a group, pretty much at or past their peaks as vigorous, expanding companies. Therefore, most of the Dow Industrials are, at best, simply hanging on (if not actually declining).

This leaves the current crop of "glamor stocks" as the only real island of strength in the market. My own feeling is that the bear market will develop with the majority of stocks continuing to take beatings and with the Dow stocks, in general, losing large percentages but holding up better than most. Finally, the glamor sector will cave in as everything ultimately gets in gear with the primary bear market on the downside.

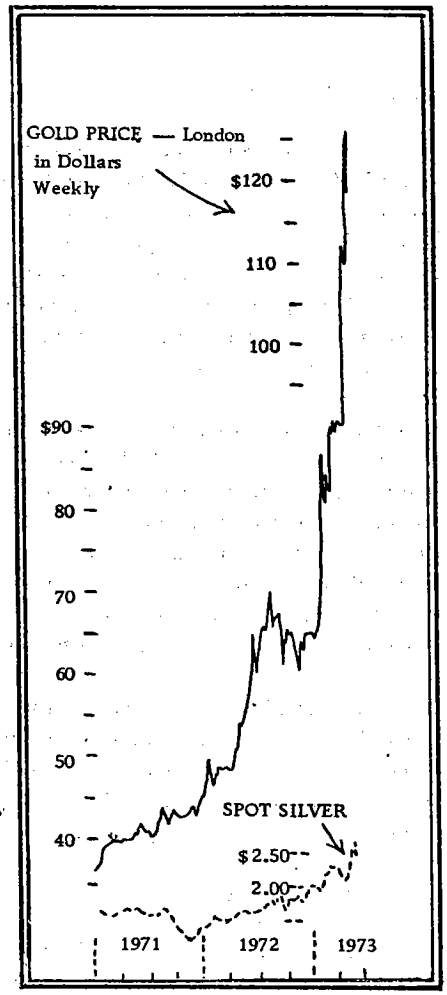
From the ashes of the bear market's final bottom, we can expect a major revival of the Dow stocks, perhaps a totally new group of glamor issues, and a recovery in many of the secondary issues, bankruptcy in others, and undoubtedly the birth of many new, promising issues (some of which will become the hope of big profits tomorrow).

STORY OF GOLD (cont' from the last Letter): No sane man really questions the power of real money. The Roman Cicero wrote, "There is no fortress so strong that money cannot take it." US President James Garfield wrote, "Whoever controls the volume of money in any country is absolute master of all industry and commerce."

All very good, but the problem is, how do we insure that the money we work for and save retains its value? Alexander Hamilton knew the crucial importance of guarding the value of a nation's currency when he wrote, "There is scarcely any point in the economy of national affair of greater moment than the uniform preservation of the intrinsic value of the money unit. On this the security and steady value of property essentially depends." That's the way our first Secretary of the Treasury saw it, a far cry from the irresponsibility of today.

Throughout history there has been only one, I repeat only one way in which a nation's money has been preserved. That is when the given currency has been freely convertible into gold (in other words, when the money was "as good as gold") and when gold was legally available to all citizens and freely traded on a true supply-demand market. The simple truth behind this is as follows: The value of gold has never been seriously questioned by any civilization in all world history. The value of any currency freely convertible into gold has never been questioned. But every "fiat" (non-gold backed) currency in history has depreciated and finally collapsed into worthlessness.

The US citizen's right to turn in his dollars for gold was revoked in 1934. Following that, only foreign nations were allowed to turn in their greenbacks for gold. In August, 1971, President Nixon embargoed gold, thus cancelling the right of the US's foreign creditors to turn in their dollars for gold. The dollar, from that time on, became a fiat currency, a piece of paper which was not tied to gold. The dollar, following August, 1971, was worth what world markets said it was worth on a daily, even an hourly basis. Since 1971, the value of the dollar has eroded to all-time lows. The best measurement of the dollar's value is the number of dollars it takes to purchase an ounce of gold on the free market. The weekly chart, therefore, represents a barometer of the dollar's worth.



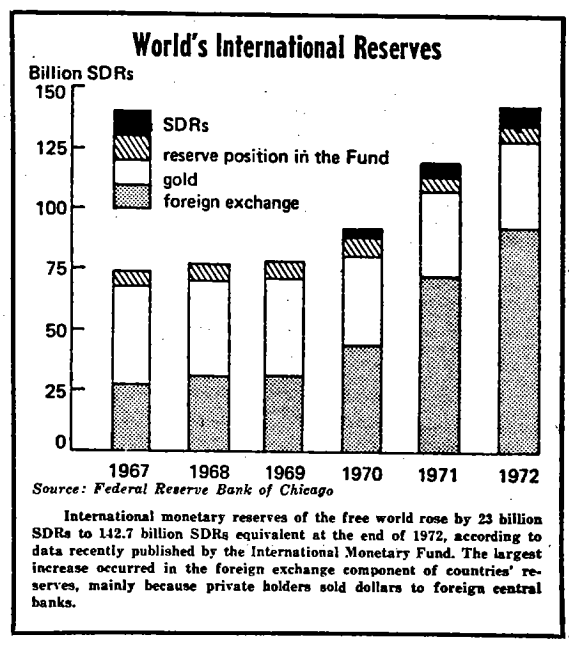
The accompanying chart shows the world situation in regards to gold reserves, paper reserves and Special Drawing Rights, the latter constituting international "paper gold" (an obvious absurdity). According to this chart (from figures released by the International Monetary Fund), the world's money reserves have been rising sharply since 1967, but the gold portion of those reserves has actually been declining! And here we come to another sad fact; the lower the gold reserve portion of a nation's reserves, the greater the distrust regarding that nation's currency. So what this chart shows us, broadly speaking, is that the quality of the world's monetary reserves has been declining. Ultimately, the world must deal with rampant inflation, a collapse in confidence and economic disaster or — a return to gold-based money.

The US has for decades been the custodian of the reserve currency, the "kingpin" currency around which all other currencies revolve. Thus, the US (with this singular power and accompanying honor) should have guarded the value of its money zealously. It did just the opposite, and systematic inflation is still the law of the land in America. At present, against its reserve of $10 billion in gold which is officially "valued" at $42.22 an ounce, the US owes at least $100 billion. This leads some astute observers such as James Dines to state that "...until the dollar is made fully and freely convertible into gold again these monetary crises will continue..." What Dines sees as absolutely essential (and I fully agree) is a revaluation of gold so that the dollar can be made "as good as gold" again. If we multiply the value of our current $10 billion gold reserves by ten, we would then have $100 billion worth of gold, enough to handle most of the foreign dollar claims against our gold. Ten times the current official price of gold is $422 per ounce for gold. That's one way of looking at it, the only fundamental one, and in my opinion, the one way that could lead us back to monetary stability.

I would make a few alterations and stipulations however. In my mind, what should be done is to raise the price even higher, to say $500 to $750 per ounce. This would allow complete convertibility, provide an extra margin of safety so that there would be no question about any debts above the $100 billion level. Furthermore, it would end speculation in gold for decades to come. And finally, it would open the gold mining industry as a profitable enterprise in the US. Gold supplies would expand again. But obviously, with a real and expanded reserve following a giant boost in the gold price, it would be absolutely essential for the world to move back to a true gold standard. All new international deficits would have to be paid off immediately with gold. Further, nations would have to institute real, tough anti-inflation laws, no question about it.

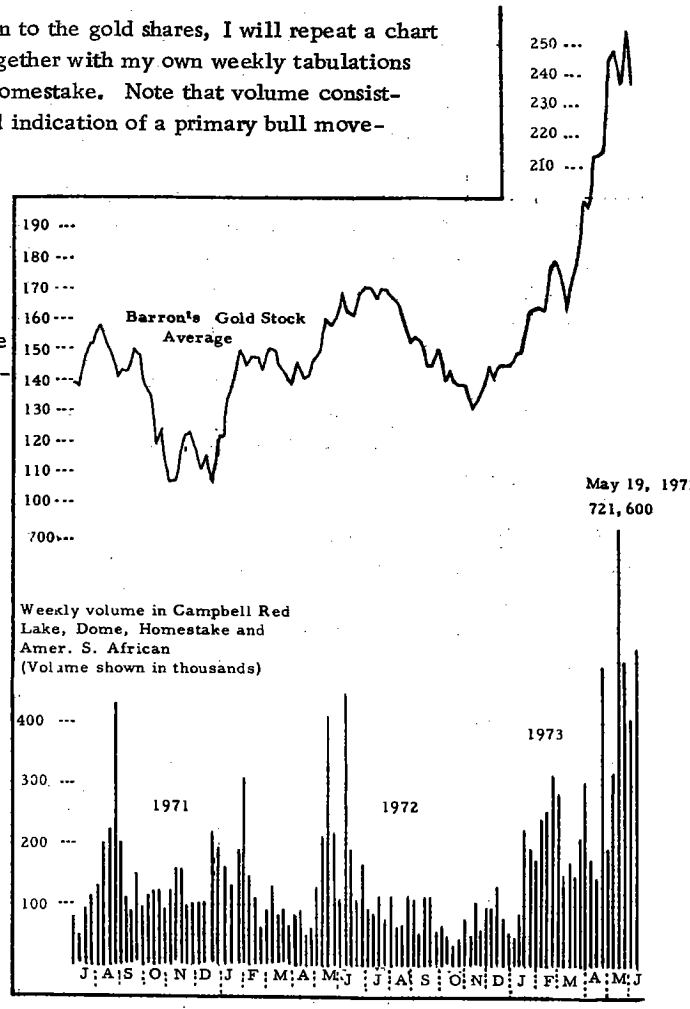
Do I think a plan such as the above can happen? The answer is that I believe it can, and I think it is the only one which has a chance of working. BUT — unfortunately, I do not know whether such a plan would be instituted before or during a depression. It should be instituted as quickly as possible. If we wait for a depression, a huge gold rise would lose much of its effect and would undoubtedly be used in an attempt to "inflate the world" out of depression. Thus, although I do not rule out a depression-inspired gold boost, it would be a tragic misuse of the power of gold.

Either way, however, world currencies must be tied to gold, the price of gold must be raised, and the shares of gold mines represent the US citizen's only hedge against what is happening and what must happen over the period ahead.



International monetary reserves of the free world rose by 23 billion SDRs to 142.7 billion SDRs equivalent at the end of 1972, according to data recently published by the International Monetary Fund. The largest increase occurred in the foreign exchange component of countries' reserves, mainly because private holders sold dollars to foreign central banks.

GOLD SHARES: Since I have been writing about the public's reaction to the gold shares, I will repeat a chart that has been seen here before. It is Barron's Gold Stock Average together with my own weekly tabulations of total volume in American South African, Campbell, Dome and Homestake. Note that volume consistently comes in on the rallies while drying up on the declines, a good indication of a primary bull movement in a stock group.

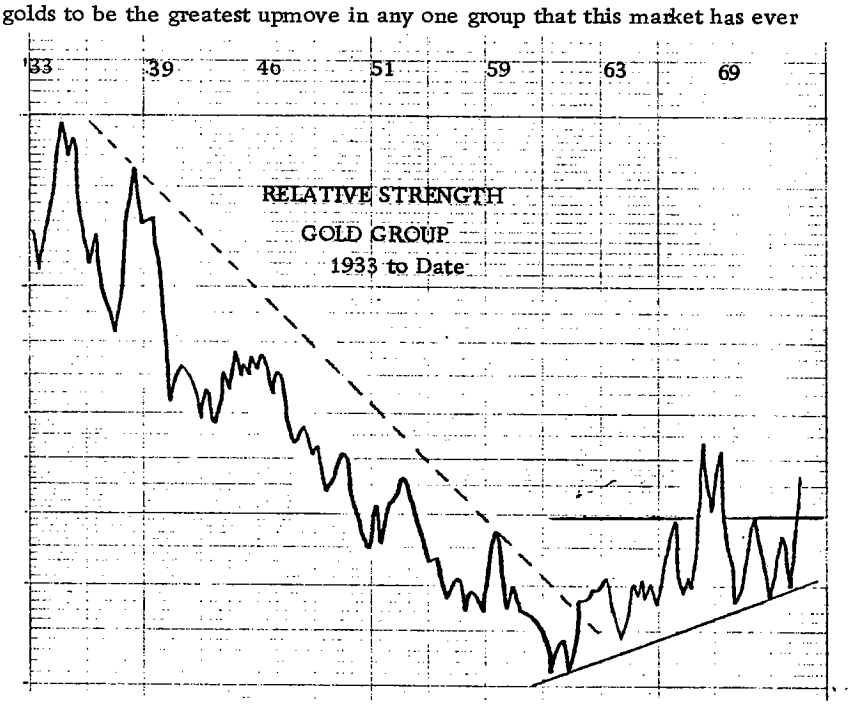


Note also that the biggest single week's volume was the 721,000 shares for the week ending May 19, 1973. That week also saw the price peak for the Gold Average, and the gold share volume for that week is now worth considering. The four stocks mentioned above comprise the four major gold shares listed on the NYSE. With all the impetus of an advance which took Barron's Gold Average from a late-1971 low of 106 to a 1973 peak of 248, not one of those four stocks made the weekly most active list. Furthermore, if volume in all four stocks were treated as volume in a single issue, the 721,000 shares of May 19 would not have made the top of the weekly most active list (weekly volume for the single most active NYSE issue usually runs 800,000 to 1,200,000).

My conclusion is that the real activity destined for gold shares has not yet been seen, and it may not be seen for six months to a year or so. Don't forget, the golds are bucking thirty years of anti-gold propaganda, persistent government propaganda, and the denials and manipulations of those who still want to accumulate gold shares at lower prices. Before the gold move is over, I would expect to see gold shares all over the daily and weekly most-active stock lists, I would expect to see weekly volume in the four major listed NYSE gold shares climbing as high as 2 million shares.

My friend E. George Schaefer, the outstanding Dow Theorist from Indianapolis (910 E. 38th St., Indianapolis, IN 45205) has been broadly right about this market for a quarter of a century. In his report of May 19, 1973, he writes, "Yes, we have had a few (gold) flurries, but those have been stopped quickly by profit taking. Thus, the public remains in doubt, waits a little longer, while the experienced trader buys up all he can get at lower prices. These are called 'false starts.' ...This may happen any number of times. But finally the public will climb aboard, take the bit in its mouth, and run away with gold and gold mining stocks. I expect the coming upmove in golds to be the greatest upmove in any one group that this market has ever had..."

I continue to receive letters from subscribers asking, "When shall I sell my gold shares?" My answer is, "Not yet," How high is high for the golds? Obviously, no one knows, but this rare and seldom-seen chart may provide some perspective (chart specially drawn for me by Ray * Signals, 43 Lake Ave., Montrose, PA 18801, and thanks Mr. Ray).



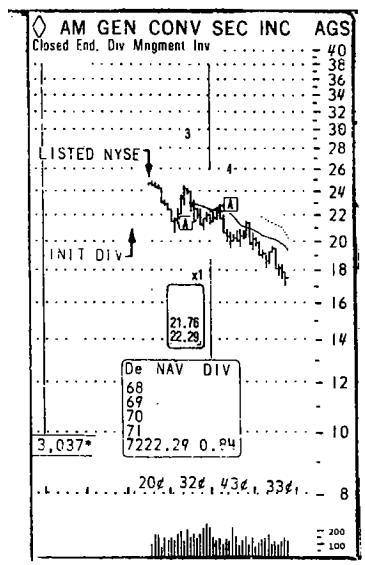
The chart covers the period from 1933 to the present! Relative strength (RS) can be likened to the "popularity" of a stock group. The higher the RS line, the more popular the group (since RS is derived by obtaining a ratio between the group and any broad market average). Note that RS for the Gold group declined on a trend basis for 26 years (1934 to 1960), following the devaluation of 1934. That meant that for three decades gold shares acted worse

than the "market." Now, 26 years of sub-performance and anti-gold propaganda is clearly enough to make almost everyone hate gold shares (or at least ignore them). By the late-1950's you couldn't give the golds away. Around 1960, the RS for the Gold group hit bottom. Although a trendline reversal in gold RS occurred in 1962, the rise in gold popularity was very gradual and subtle. the 1968-69 currency crisis boosted gold RS, but interest soon subsided again. The RS shows a sideways to gradual rise in gold over the past 10 years.

Again the question, "How high could gold shares go?" My answer is that they could climb substantially from here. Remember, the 1934 level on the RS chart does not measure price, it measures enthusiasm or popularity of the Gold group. If the Gold group were to match the popularity it enjoyed during 1934 (and I don't know why it shouldn't), golds could continue to climb for another year or so against a background of a bear market in the great majority of common stocks. The picture for gold RS will be reviewed here as it becomes more and more critical.

I have been asked what gold shares I like at this time. Gold shares are not the great bargains they were a year or so ago, but I like Campbell Red Lake, American South-African, Homestake (all on the NYSE) plus ADR's in the following S. African mines still represent a good hedge against continuing monetary insanity: East Driefontein, Vaal, Reefs, Kloof, West Driefontein, Elsburg.

Unfortunately, this gold article is taking up more space than I thought it would when I started it in the last mailing. But I have a great many new subscribers, and I feel it is vital that they understand gold fundamentals. Therefore, I will try to conclude the gold article in the next mailing. In the meantime, golds have been in a long-needed correction, and for those who own small amounts or no gold shares, the next few weeks should provide a chance to accumulate shares of the yellow metal.



NOTES AND THOUGHTS: As seen on the composite page 1 chart, the 91-day Treasury bills now yield 7%, (vs. 7.2% for Aaa-rated Industrial Bonds). This takes our bond-bill ratio down near 1.0, a dangerous level (see Letter 563, page 4). The ratio is saying that the long-term and short-term money markets are "out of whack," and that either long-term rates are going up or short-term rates are coming down.

In Letter 555 I drew attention to American General Convertible Securities, a closed-end bond fund which trades on the NYSE like any other stock. This interesting fund had just broken 20 at the time; it is now under 18. With a monthly dividend of 11¢ ($1.32 per year), AGS now provides a yield of about 7.6%. The stock owns a diversified list of convertible securities (mostly bonds), and it is managed by an outfit that knows its stuff, American General Management Co. (a subsidiary of Amer. Gen. Insurance Co.).

As seen on the weekly chart (courtesy of Quote, PO Box 213, Wichita, KS 67201), AGS is currently down almost 1/3 from its high of 25 1/8! AGS is selling at an 8% discount from its current asset price of $19.29. For those who want yield, a "jazzy" place to invest some extra money and a potential of some pointage in a market rally, AGS is an interesting place. I would think that AGS would be quite resistant to the downside from here, since the 7.6% yield is tending to hold it up (regardless of the prices of the stocks which its bonds and preferred are convertible into). My bet is that in five years we will look back and see that today's amazingly high interest rates (and bond yields) offered a once-in-a-generation opportunity in bonds. Either that, or capitalism, as we know it in the US, will cease to exist.

DOW STOCKS: I keep very extensive technical records of the Dow stocks. The Dow Industrial Average is outperforming the broad, representative averages and the individual Dow stocks showing outstanding relative strength are Alcoa, Proctor and Gamble, American Can, Telephone, Beth. Steel, Kodak, and Exxon. Two depressed stocks showing upturns in relative strength are Westinghouse and Woolworth.

On my technical scale of a zero to five rating for each Dow stock, out of a possible 150 peak of strength, the 30 Dow stocks now register a very low 37. Current strongest stock (see last Letter) is American Can with a rating of 4. General Foods and Woolworth have a rating of 3 each, and these constitute the strongest of the Dow stocks.

LATE, LATE NOTE: The most-active stock index (see Letter 564, page 4) continues to stay on the minus side with almost dogged determination. The June 8 reading was a whopping minus 49, and from this I conclude that distribution is still going on in this market. One thing to watch, however, would be a trend to plus reading on the most-active stock index.